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May 18, 2015

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Subcommittee on Defense  
Committee on Appropriations  
United States Senate

The Honorable Rodney Frelinghuysen  
Chairman  
The Honorable Peter Visclosky  
Ranking Member  
Subcommittee on Defense  
Committee on Appropriations  
House of Representatives

### **Defense Contracting: Observations on Air Force Use of Undefinitized Contract Actions**

To meet urgent needs, the Department of Defense (DOD) can authorize contractors to begin work and incur costs before reaching final agreement on contract terms, specifications, or price, using an undefinitized contract action (UCA).<sup>1</sup> This type of contractual action is considered risky for the government because contractors have little incentive to control costs as the government normally reimburses contractors for all allowable costs incurred during the undefinitized period. Further, the government may incur unnecessary costs if requirements change before the contract is definitized. To help minimize these risks, defense acquisition regulations generally require UCAs to be definitized within 180 days of issuance of the contract action or before more than 50 percent of the estimated contract price is obligated, whichever occurs first.<sup>2</sup>

We have previously reported on DOD's efforts to provide oversight of UCAs and meet its required definitization time frames. In June 2007, we found that DOD did not know the extent to which it was using UCAs and identified the need for the department to improve oversight and its ability to meet required definitization time frames.<sup>3</sup> In response, the department issued a new policy in 2008 on UCA oversight and management which, among other things, required DOD components to report semiannually on UCAs with an estimated value exceeding \$5 million to the Office of the Under Secretary of Defense for Acquisition, Technology & Logistics, Defense Procurement and Acquisition

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<sup>1</sup>A definitized contract action is one in which all terms and conditions, including price, are agreed to by the parties to the contract at the time of contract award.

<sup>2</sup>Defense Federal Acquisition Regulation Supplement (DFARS) § 217.7404-3(a) (1) and (2).

<sup>3</sup>*Defense Contracting: Use of Undefinitized Contract Actions Understated and Definitization Time Frames Often Not Met, GAO-07-559* (Washington, D.C.: June 19, 2007).

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Policy (DPAP).<sup>4</sup> In turn, DPAP uses these data to provide a mandated report to Congress on DOD's use of UCAs. In January 2010, we found that these efforts enhanced DOD's oversight of UCAs across the department; however, we also found that incomplete data continued to hinder its full understanding of the extent to which UCAs are used.<sup>5</sup>

Federal procurement data show that DOD obligated \$110 billion on UCAs from fiscal years 2010 through 2014, or 6 percent of its total contract obligations. Of this amount, the Air Force obligated \$31 billion on UCAs.<sup>6</sup> The joint explanatory statement accompanying the Consolidated and Further Continuing Appropriations Act for Fiscal Year 2015 included a provision for GAO to review the Air Force's use of UCAs.<sup>7</sup> This report addresses (1) patterns in the Air Force's use of UCAs and (2) reasons the Air Force awarded undefinitized actions and the extent to which the Air Force adhered to UCA policies and procedures.

To assess patterns in the Air Force's use of UCAs, we analyzed data from the Federal Procurement Data System-Next Generation (FPDS-NG) from fiscal years 2010 through 2014, the most recent data available to show trends over time.<sup>8</sup> We determined that these data were sufficiently reliable for our purposes by conducting electronic testing to verify the completeness and accuracy of data reported in FPDS-NG and reviewing a selection of contract documents to confirm accurate coding of UCAs. Our trend analysis excluded about \$17 billion in Air Force UCA obligations for the sale of defense articles through the Foreign Military Sales (FMS) program as these transactions are foreign funded and driven by foreign government requirements. All obligation data presented in this report are adjusted for inflation and displayed in constant 2014 dollars unless otherwise noted.

To identify the reasons for the Air Force's use of UCAs and to assess the extent to which it met current UCA policies and procedures, we focused our work on UCAs awarded from fiscal years 2012 through 2014. Using FPDS-NG data, we determined that the Air Force Life Cycle Management Center (AFLCMC) accounted for nearly half of all non-FMS Air Force UCA obligations during this time period. We then selected a non-generalizable sample of 10 non-FMS undefinitized actions awarded by AFLCMC.<sup>9</sup> We selected contract actions from two AFLCMC programs—MQ-9 Reaper unmanned aerial vehicle (UAV) and C-130J transport aircraft—based on the programs' high UCA obligation levels. For the selected contracts, we reviewed approval documents and interviewed contracting officials to identify the reasons for using a UCA. To assess the extent to which the Air Force adhered to current UCA policies and procedures, we reviewed applicable laws and regulations, including the Federal Acquisition Regulation, the Defense Federal Acquisition Regulation Supplement (DFARS), the Air Force Federal Acquisition Regulation Supplement, and other applicable DOD and Air Force guidance, and interviewed DPAP and Air Force acquisition

<sup>4</sup>*Management Oversight of Undefinitized Contract Actions*, memorandum from the Director, Office of Defense Procurement and Acquisition Policy (Aug. 29, 2008).

<sup>5</sup>*Defense Contracting: DOD Has Enhanced Insight into Undefinitized Contract Action Use, but Management at Local Commands Needs Improvement*, [GAO-10-299](#) (Washington, D.C.: Jan. 28, 2010).

<sup>6</sup>All obligation data presented in this report are adjusted for inflation and displayed in constant 2014 dollars unless otherwise noted.

<sup>7</sup>See 160 Cong. Rec. H9307, H9523 (daily ed. Dec. 11, 2014).

<sup>8</sup>FPDS-NG is the primary government-wide contracting database that provides information on government contracting actions.

<sup>9</sup>We initially identified an additional UCA, but our review of contract documents showed that this contract action was miscoded and not a UCA. Therefore we have excluded it from our analysis.

officials. We reviewed contract documents to determine if the Air Force obtained the required approvals, limited obligations, and met definitization time frames or notified Air Force officials of any delays. In addition, we reviewed DOD semi-annual UCA reports to Congress for fiscal years 2013 and 2014 to determine if Air Force UCAs were properly reported.

We conducted this performance audit from February to May 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## **Results in Brief**

The Air Force obligated \$14 billion on non-FMS UCAs from fiscal years 2010 through 2014. Over this period, five major space and aircraft programs drove the Air Force's obligation trends, which peaked in fiscal year 2012 at \$4.5 billion before declining to \$1.1 billion in fiscal year 2014. For the 10 UCAs that we reviewed, the most common reason cited by Air Force contracting officials was to meet urgent needs. The Air Force met requirements to obtain approval prior to awarding a UCA and limit obligations for awards in our sample. However, we found that the Air Force did not meet definitization time frames for the actions that we reviewed and may be underreporting UCAs in DOD's semiannual report to Congress. Air Force contracting officials said it has been standard practice to exclude undefinitized long-lead contracts from UCA semiannual reporting because these types of procurements are not subject to the other defense acquisition requirements for UCAs. DOD guidance, however, calls for the inclusion of all UCAs valued over \$5 million in the semiannual reports to Congress, including procurements exempt from UCA requirements. During the course of our review, the Deputy Assistant Secretary of the Air Force for Contracting issued a memorandum in April 2015 to all Air Force contracting commands reiterating that all UCAs, including those for long-lead items, are to be reported to DPAP for inclusion in DOD's semiannual reports to Congress.

## **Background**

Defense acquisition regulations define UCAs as any contract action for which the contract terms, specifications, or price are not agreed upon before performance begins under the action.<sup>10</sup> UCAs can take several forms, such as a letter contract (an undefinitized stand-alone contract), an undefinitized task or delivery order issued against a pre-established umbrella contract, or an undefinitized modification for additional supplies or services to an existing contract. UCAs are required to be approved by the head of the contracting activity prior to issuance and to be definitized within 180 days of issuance of the action or before more than 50 percent of the estimated contract price is obligated, whichever occurs first. After the receipt of a qualifying proposal that contains sufficient data for DOD to complete an audit, definitization time frames can be extended to no more than 180 days after the qualifying proposal submission and obligation levels can be increased up to 75 percent of the estimated value of the action.<sup>11</sup> To monitor definitization schedules, Air Force acquisition regulations require monthly reporting on any UCA with a delay in its planned definitization schedule and any remedial actions that may be taken to reduce further delays.<sup>12</sup>

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<sup>10</sup>DFARS § 217.7401(d).

<sup>11</sup>DFARS §§ 217.7404-3 and 217.7404-4.

<sup>12</sup>Air Force Federal Acquisition Regulations Supplement § 5317.7404-3.

Defense acquisition regulations exempt certain procurements from the UCA definitization time frames and obligation limitation requirements. These procurements include UCAs for FMS and congressionally mandated long-lead items. Congressionally mandated long-lead items include components and other materials that need to be procured early to reduce production lead times and ensure that planned production schedules are maintained for the related end item, such as an entire aircraft. These long-lead items are procured using advance procurement funds, which are authorized by Congress, to allow DOD to obligate and disburse funds in the fiscal year prior to the procurement of the related end item. Defense acquisition regulations require, however, that contracting officers follow definitization time frames and obligation limitations to the maximum extent possible for these types of purchases. If the contracting officer determines that it is impracticable to follow UCA procedures outlined in defense acquisition regulations for these types of procurements, the contracting officer shall provide notice to DPAP of this determination prior to awarding the UCA.<sup>13</sup> Air Force acquisition regulations also require that notification be provided to the Office of the Deputy Assistant Secretary of the Air Force for Acquisition 30 days prior to the issuance of any UCA for FMS or congressionally mandated long-lead procurements when it is impracticable to adhere to the UCA requirements.<sup>14</sup>

To provide enhanced oversight of UCAs, defense acquisition regulations require the military departments and defense agencies to report semiannually on UCAs with an estimated value exceeding \$5 million. DPAP consolidates this information and provides Congress with semiannual reports on DOD's use of UCAs. DPAP guidance instructs DOD components to report all UCAs valued over \$5 million, including procurements that are exempt from UCA definitization and obligation requirements, such as FMS procurements or congressionally mandated long-lead items.<sup>15</sup> Information to be reported to DPAP on each UCA includes, among other things,

- the estimated price,
- the percent of the estimated price that had been obligated on the contract,
- the award date,
- the date of scheduled definitization, and
- the date the qualifying proposal was received.

The Air Force developed a web-based tool to facilitate the collection of the information required for submission in the semiannual reports. Air Force acquisition regulations require commands to update this information monthly using the UCA reporting tool.

### **Small Number of Air Force Programs Drove Trends in Obligation Levels for Undefined Contract Actions**

Air Force non-FMS UCA obligations totaled over \$14 billion from fiscal years 2010 through 2014, accounting for 5 percent of the Air Force's non-FMS contract obligations during this time period.<sup>16</sup>

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<sup>13</sup>DFARS § 217.7402(b).

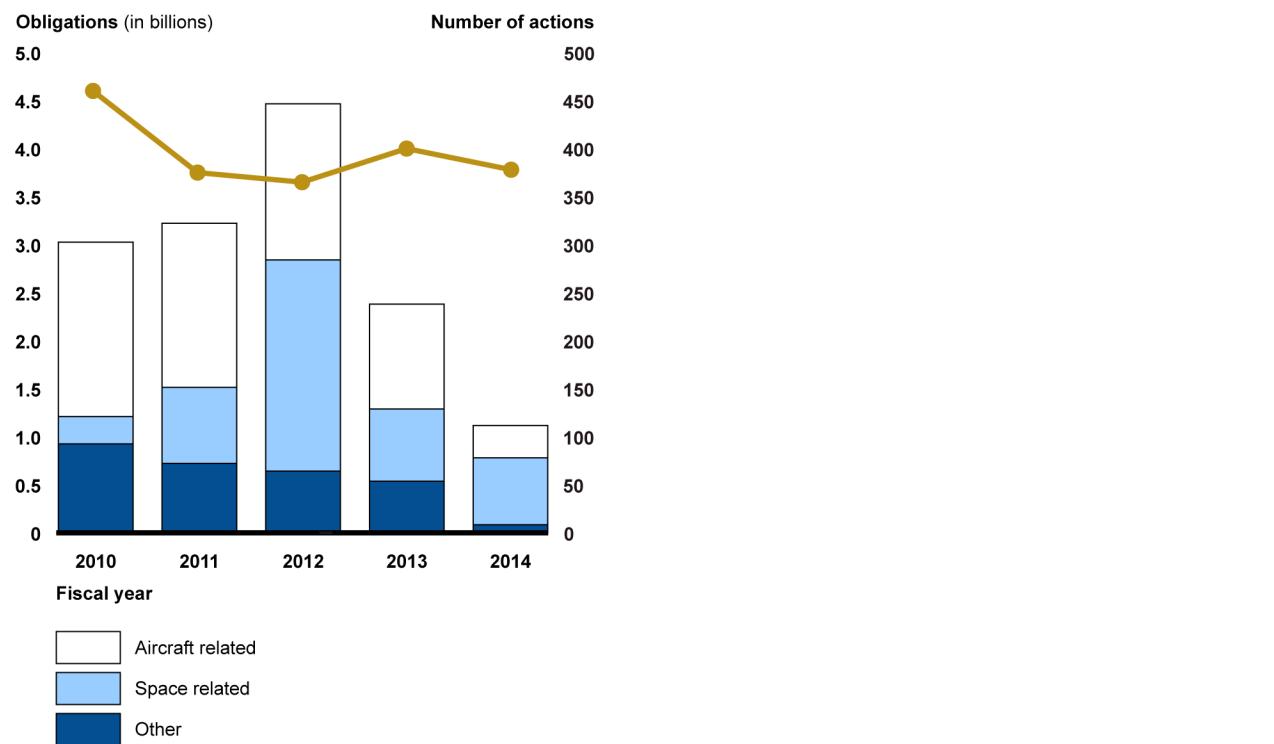
<sup>14</sup>Air Force Federal Acquisition Regulation Supplement § 5317.7402(b).

<sup>15</sup>DFARS § 217.7405.

<sup>16</sup>Our analysis does not include approximately \$17 billion in Air Force FMS UCA obligations as these procurements are foreign funded and driven by the foreign government and processes outside the control of the contracting office.

These obligations peaked in fiscal year 2012 at \$4.5 billion before declining to \$1.1 billion in fiscal year 2014. After a decrease in actions from fiscal years 2010 to 2011, the number of Air Force contracts and orders with undefinitized actions has remained relatively constant for fiscal years 2011 through 2014, as shown in figure 1.

**Figure 1: Air Force Number of Contracts and Orders with Undefinitized Actions and Associated Obligations In 2014 Constant Dollars, Fiscal Years 2010 through 2014**



Note: Obligation data on Air Force undefinitized actions for foreign military sales are not included. Obligations in figure are adjusted for inflation and presented in constant 2014 dollars.

Air Force UCA obligation trends from fiscal years 2010 through 2014 were driven largely by five major space and aircraft programs, which accounted for over 44 percent of Air Force UCA obligations during this time period. These programs include the Evolved Expendable Launch Vehicle (EELV), C-17A transport aircraft, Advanced Extremely High Frequency (AEHF) satellite, C-130J transport aircraft, and Reaper UAV. For example, the increase in fiscal year 2012 can largely be attributed to UCA obligations totaling \$1.5 billion for the EELV program, which provides space launch vehicles and services for U.S. military and intelligence satellites. We have previously found that the EELV program faced challenges in obtaining cost or pricing data necessary to complete contract negotiations and finalize terms.<sup>17</sup> In addition, the Air Force obligated \$718 million in fiscal year 2012 on UCAs for the C-17A transport aircraft. After fiscal year 2012, the AEHF, C-130J, and Reaper programs accounted for over 40 percent of Air Force UCA obligations.

<sup>17</sup>National Defense: The Air Force's Evolved Expendable Launch Vehicle Competitive Procurement, GAO-14-377R (Washington, D.C.: Mar. 4, 2014) and Evolved Expendable Launch Vehicle: DOD Needs to Ensure New Acquisition Strategy is Based on Sufficient Information, GAO-11-641 (Washington, D.C.: Sept. 15, 2011).

## Air Force Implementation of Requirements Varied for the Undefinitized Actions Reviewed

For the 10 UCAs we reviewed, the Air Force justified their use to meet urgent needs or avoid a lapse in production. Nine of the 10 actions that we reviewed were subject to UCA regulations and we found that the Air Force met requirements to obtain approval prior to award, and limit obligations for these UCAs. However, we found that the Air Force did not meet definitization time frames for the actions that we reviewed and may be underreporting UCAs in DOD's semiannual report submitted to Congress.

### Urgent Needs Are Most Common Reason Cited for Awarding Undefinitized Contract Actions

Air Force contracting officials cited urgent needs as the most common reason for awarding UCAs that we reviewed. For example, in December 2013, a joint urgent operational need was validated to procure Reaper UAV with extended range capabilities for delivery within 15 months. In this instance, Air Force contracting officials noted that normal contract timelines would not allow for delivery within the required time frames. Further, Air Force officials told us that the contractor is on track to deliver the UAV with extended range capabilities within the requested 15 month time frame. Air Force contracting officials also said that extended range capability has been validated as a long term requirement and the Air Force plans to procure these capabilities in the future using definitized contracts.

Air Force contracting officials also cited the need to avoid a lapse in production as a reason for awarding some UCAs in our sample. For example, in two other Reaper UCAs that we reviewed, there were development and testing challenges that delayed the contract award for the fiscal year 2012 procurement. Due to these delays, definitized procurement contracts could not be awarded as planned and UCAs were awarded to avoid a 5 month gap in production while development and testing solutions were finalized.

### Air Force Met Approval and Obligation Limitation Requirements, but Experienced Definitization Delays

Air Force contracting officials obtained the required approval prior to issuance for all of the actions that we reviewed and met the requirement to limit obligations prior to definitization. Defense acquisition regulations limit obligations on UCAs to 50 percent of the estimated contract price before definitization. All nine of the UCAs in our sample that were subject to the limitation obligated less than 50 percent of the estimated contract price at award, obligating between 18 and 49 percent of the estimated contract price. Defense acquisition regulations further allow contracting officers to increase obligations up to 75 percent of the estimated contract price upon receipt of a qualifying proposal, which is defined as a proposal containing sufficient data for DOD to do a complete and meaningful audit. Obligations for seven of the nine UCAs that we reviewed remained below 50 percent of the estimated contract price prior to definitization. For the two remaining actions, obligations increased to 63 and 67 percent, respectively, of the estimated price after the qualifying proposals were received.

None of the nine UCAs that we reviewed were definitized within 180 days of contract award.

- Two of the 9 actions were definitized within 180 days of receipt of the qualifying proposal, as permitted by defense acquisition regulations.<sup>18</sup>

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<sup>18</sup>DFARS § 217.7404-3(a)(1) requires that UCAs be definitized within 180 days of contract award. This date may be extended, but may not exceed 180 days after the contractor submits a qualifying proposal.

- The remaining seven actions that we reviewed were not definitized within 180 days of award or the submission of the qualifying proposal and definitization time frames ranged from 203 to 661 days from award.

To monitor definitization schedules, Air Force acquisition regulations instruct contracting officers to report on any UCA with a delay in its planned definitization schedule using its monthly reporting tool.<sup>19</sup> Consistent with this regulation, contracting officials reported the extended due date for definitization in the Air Force reporting tool for eight of the nine actions that we reviewed.

Air Force contracting officials cited a lack of sufficient pricing data as the most common reason for definitization delays. For example, a contract awarded for the C-130J fiscal year 2012 aircraft procurement valued at over \$880 million took 661 days to definitize due to a lack of sufficient pricing data in the contractor's proposal. Air Force contracting officials said that 90 percent of the subcontractor and commercial pricing data included in the contractor's original proposal were deemed insufficient. According to Air Force contracting officials, multiple proposals were required from the contractor to obtain sufficient pricing data. Air Force contracting officials reported withholding payments to incentivize the submission of sufficient pricing data, but could not confirm that it had any effect on proposal quality. Further, Air Force contracting officials attributed these price inadequacies, in part, to the sole source environment for the C-130J procurements which may have reduced the incentive for contractors to submit adequate proposals.

In addition to delays due to inadequate pricing data, one contract in our sample was delayed due to changing requirements. The Air Force awarded a UCA in April 2013 to integrate a sensor onto the HC/MC-130J aircraft that took over 500 days to definitize. Air Force contracting officers explained that an additional requirement was added during contract performance and required an additional proposal and negotiation process before the contract could be finalized.

#### Air Force Did Not Report All Undefinitized Actions, but Has Taken Corrective Action

During the course of our review, we found that AFLCMC does not report UCAs awarded for advance procurement of long-lead items in the Air Force's monthly reporting tool and therefore these UCAs are not reported in DOD's semiannual UCA report to Congress. For example, using federal procurement data, we identified a contract awarded by AFLCMC in December 2013 for the advance procurement of long-lead components for the fiscal year 2014 C-130J aircraft procurement that was not reported in DOD's semiannual reports to Congress.<sup>20</sup> AFLCMC acquisition officials said that it has been standard practice to exclude undefinitized long-lead contracts from UCA reporting requirements because these types of procurements are considered congressionally mandated long-lead items, which are not subject to other defense acquisition requirements for UCAs, such as the 180-day definitization schedule or limiting obligations to 50 percent of the estimated contract price. DOD guidance, however, instructs the military departments and defense agencies to include all UCAs valued over \$5 million for exempted categories in their semiannual report submission. In contrast, we found that AFLCMC does report UCAs for FMS transactions, which, similar to the congressionally mandated long-lead items, are also exempt from definitization time frames and obligation limitation requirements.

AFLCMC acquisition officials said that it typically awards undefinitized long-lead contracts using advance procurement funds to allow the contractor to begin work or keep production facilities

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<sup>19</sup>Air Force Federal Acquisition Regulation Supplement § 5317.7404-3.

<sup>20</sup>This contract includes fiscal year 2014 procurement of the C-130J, HC-130J, MC-130J, and the AC-130J.

operational while the purchase of the related end item, such as an aircraft, is negotiated. Officials said this contracting approach allows the Air Force to conduct a single negotiation for the procurement, rather than separate efforts for long-lead components and the related end item. Once procurement funds have been obligated for the end item, and if the final terms and conditions cannot be negotiated, then Air Force guidance specifies that the contract would be subject to applicable defense and Air Force UCA requirements. This includes the requirement to definitize the UCA within 180 days and to limit obligations to less than 50 percent of the estimated contract price. In one example that we reviewed, the Air Force awarded a \$170 million UCA to acquire long-lead items to support the C-130J fiscal year 2014 aircraft procurement. The Air Force estimated it would definitize the entire procurement within 324 days of award. However, the contract for the fiscal year 2014 C-130J aircraft had not been fully negotiated as of March 2015 and as a result, the UCA for the long-lead items remains undefinitized for more than 490 days after it was awarded. Contracting officials explained that the absence of sufficient pricing data in the contractor's proposal has prolonged negotiations and therefore delayed definitization of the total aircraft procurement and the obligation of procurement funds for the C-130J aircraft. As a result, more than 90 percent, or \$1.4 billion, of the program's fiscal year 2014 procurement funds have not been obligated more than a year after being appropriated.

DPAP and Air Force officials reiterated that DOD and Air Force policy call for reporting congressionally mandated long-lead UCAs in DOD's semiannual reports to Congress and the Air Force's monthly reporting tool, respectively. Representatives from the Office of the Deputy Assistant Secretary of the Air Force for Contracting were not aware if other commands were also underreporting congressionally mandated long-lead UCAs, but noted that none had been reported in the monthly tracking tool since 2011. In April 2015, the Deputy Assistant Secretary of the Air Force for Contracting issued a memorandum to all contracting commands reiterating that UCAs for congressionally mandated long-lead items are to be reported in the Air Force monthly reporting tool.

Based on the Air Force's action, we are not making any recommendations in this report.

### **Agency Comments**

We provided a draft of this report to DOD for comment. DOD provided technical comments that were incorporated as appropriate.

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